



OFFICE OF
INSURANCE COMMISSIONER

December 4, 2002 (Revised 12-23-2002, see endnotes.)

STATE OF WASHINGTON NOTICE TO PROPERTY AND CASUALTY COMPANIES

FOR:

1. ALL PROPERTY AND CASUALTY INSURERS WRITING COMMERCIAL LINES INSURANCE PRODUCTS
2. ALL INSURERS ON THE NAIC QUARTERLY LISTING OF ALIEN INSURERS

RE: TERRORISM RISK INSURANCE ACT OF 2002

Background

There has been much uncertainty in the markets for commercial lines property and casualty insurance coverage in light of the substantial losses experienced by the industry on September 11, 2001. Soon after the tragic events, many reinsurers announced that they did not intend to provide coverage for acts of terrorism in future reinsurance contracts. This led to a concerted effort on behalf of all interested parties to seek a temporary federal backstop to calm market fears over future terrorist attacks and the ability of the insurance industry to allocate capital to provide coverage for these unpredictable and potentially catastrophic events. Congress recently enacted and the President has signed into law, the Terrorism Risk Insurance Act of 2002 (the Act). This federal law provides a federal backstop for defined acts of terrorism and imposes certain obligations on insurers.

The intent of this notice is to advise you of certain provisions of the Act, and to inform you of filing procedures, since the Act requires admitted insurers to submit filings in this state.

Section 102(6) of the Act defines "insurers" for purposes of the Act. "Insurer" means any entity and affiliate thereof--(A) that is--(i) licensed or admitted to engage in the business of providing primary or excess insurance in any State; (ii) an eligible surplus line carrier listed on the Quarterly Listing of Alien Insurers of the NAIC, or any successor thereto; (iii) approved for the purpose of offering property and casualty insurance by a Federal agency in connection with maritime, energy, or aviation activity; (iv) a State residual market insurance entity or State workers' compensation fund; (B) that receives direct earned premium for any type of commercial property and casualty insurance coverage. The Secretary of the Treasury may extend the Act to other classes or types of captive insurers and other self-insured arrangements by municipalities and other entities as well as to group life insurance.

Section 102(12) of the Act states the term "property and casualty insurance" (A) means commercial lines of property and casualty insurance, including excess insurance, workers' compensation insurance, and surety insurance, and (B) does not include Federal crop, or any other type of crop or livestock insurance, private mortgage or title insurance, financial guaranty

insurance issued by monoline financial guaranty insurance corporations, medical malpractice, health or life insurance including group life, flood insurance provided under the National Flood Insurance Act, or reinsurance or retrocessional reinsurance.

All insurers (whether admitted or non-admitted), as defined in the Act, are required by the Act to participate in the Terrorism Insurance Program (the Program) and make available coverage for *insured losses* in all of their covered commercial lines policies. The term “*insured loss*” means any loss resulting from an act of terrorism (including an act of war, in the case of workers’ compensation) that is covered by primary or excess property and casualty insurance issued by an insurer if such loss—(i) occurs within the United States; or (ii) occurs in an air carrier (as described in section 40102 of title 49, United States Code), to a United States flag vessel (or a vessel based principally in the United States, on which United States income tax is paid and whose insurance coverage is subject to regulation in the United States), regardless of where the loss occurs, or at the premises of a United States mission. The Act also advises that insured loss excludes amounts awarded in a civil action that are attributable to punitive damages. The Act further requires insurers to make available property and casualty insurance coverage for *insured losses* that do not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism.

The Act voids any terrorism exclusions in a contract for property and casualty insurance that is in force on the date of enactment of this Act to the extent that it excludes losses that would otherwise be *insured losses*. The Act also voids any state approval of any terrorism exclusion from a contract for property or casualty insurance that is in force on the date of enactment of this Act to the extent that it excludes losses that would otherwise be *insured losses*. The Act allows insurers to “reinstate a preexisting provision in a contract for commercial property and casualty insurance that is in force on the date of enactment of this Act and that excludes coverage for acts of terrorism only” if one of two conditions are met. The alternative conditions are: (1) The insurer has received a written statement from the insured that affirmatively authorizes such reinstatement, or (2) the insurer has provided notice to the insured, at least 30 days before any such reinstatement, and the insured fails to pay any increased premium charged by the insurer for providing such terrorism coverage.

Definition of Insured Loss

Section 102(5) of the Act provides a definition of *insured loss*. It states, “the term ‘insured loss’ means any loss resulting from an act of terrorism (including an act of war, in the case of workers’ compensation) that is covered by primary or excess property and casualty insurance issued by an insurer if such loss—(A) occurs within the United States; or (B) occurs to an air carrier (as defined in section 40102 of title 49, United States Code), to a United States flag vessel (or a vessel based principally in the United States, on which United States income tax is paid and whose insurance coverage is subject to regulation in the United States), regardless of where the loss occurs, or at the premises of any United States mission.”

As a result of the definition contained in the Act, there are essentially two distinct types of losses that a business might face that result from terrorism. One type of loss is the *insured loss* that is defined within and covered by the provisions of the Act. For convenience, we will adopt the moniker of “certified loss” to refer to losses resulting from certified acts of terrorism. The second type of loss that a business might face is one that does not fit within the definition of *insured loss* as described in the Act. For convenience, we will adopt the moniker of “non-certified loss” to refer to losses resulting from terrorism that is not certified. The most significant difference

between these losses is that the *certified losses* will always involve a foreign person or foreign interest, while the *non-certified losses* may not.

Please note that the preemption of this state's form filing laws, including RCW 48.18.103, applies only to contract language that is applicable to certified losses. If an insurer intends to reinstate an exclusion on in-force policies as allowed under the Act, it may only reinstate an exclusion that previously existed on the policy. This state has allowed, and will continue to allow, some significant limitations that provide coverage for acts of terrorism under certain circumstances. For policies providing property insurance coverage the following limitations apply to *non-certified losses*:

- Exclusion for acts of terrorism apply only if the acts of terrorism result in industry-wide insured losses that exceed \$25,000,000 for related incidents that occur within a 72 hour period;
- Exclusions for acts of terrorism are not subject to limitations above if:
 - The act involves the use, release or escape of nuclear materials, or that directly or indirectly results in nuclear reaction or radiation or radioactive contamination;
 - The act is carried out by means of the dispersal or application of pathogenic or poisonous biological or chemical materials; or
 - Pathogenic or poisonous biological or chemical materials are released, and it appears that one purpose of the terrorism was to release such materials.

For policies providing liability insurance coverage the following limitations apply to *non-certified losses*:

- Exclusion for acts of terrorism apply only if the acts of terrorism result in industry-wide insured losses that exceed \$25,000,000 for related incidents that occur within a 72 hour period; or
- Fifty or more persons sustain death or serious physical injury for related incidents that occur within a 72 hour period. For purposes of this provision serious physical injury means:
 - Physical injury that involves a substantial risk of death;
 - Protracted and obvious physical disfigurement; or
 - Protracted loss of or impairment of the function of a bodily member or organ.
- Exclusions for acts of terrorism are not subject to limitations above if:
 - The act involves the use, release or escape of nuclear materials, or that directly or indirectly results in nuclear reaction or radiation or radioactive contamination;
 - The act is carried out by means of the dispersal or application of pathogenic or poisonous biological or chemical materials; or
 - Pathogenic or poisonous biological or chemical materials are released, and it appears that one purpose of the terrorism was to release such materials.

Definition of Act of Terrorism

Section 102(1) defines an *act of terrorism* for purposes of the Act. Section 102(1)(A) states, "The term 'act of terrorism' means any act that is certified by the Secretary, in concurrence with the secretary of State, and the Attorney General of the United States—(i) to be an act of terrorism; (ii) to be a violent act or an act that is dangerous to—(I) human life; (II) property; or (III) infrastructure; (iii) to have resulted in damage within the United States, or outside the United States in the case of—(I) an air carrier or vessel described in paragraph (5)(B); or (II) the premises of a United States mission; and (iv) to have been committed by an individual or

individuals acting on behalf of any foreign person or foreign interest, as part of an effort to coerce the civilian populations of the United States or to influence the policy or affect the conduct of the United States Government by coercion.” Section 102(1)(B) states, “No act shall be certified by the Secretary as an act of terrorism if—(i) the act is committed as part of the course of a war declared by the Congress, except that this clause shall not apply with respect to any coverage for workers’ compensation; or (ii) property and casualty insurance losses resulting from the act, in the aggregate, do not exceed \$5,000,000.” Section 102(1)(C) and (D) specify that the determinations are final and not subject to judicial review and that the Secretary of the Treasury cannot delegate the determination to anyone.

This state will not allow exclusions of coverage for acts of terrorism that fail to be *certified losses* solely because they fall below the \$5,000,000 threshold in Section 102(1)(B). Insurers required to file policy forms may submit exclusionary language for *certified losses* that exceed \$100 billion.

In this notice the term *certified losses* has the same meaning as losses from “acts of terrorism” as defined in the Act. Policies subject to policy form filing requirements should also define what constitutes an act of terrorism for *non-certified losses*. For *non-certified losses*, this state would accept the following definition, or one that is more liberal to policyholders:

The phrase “non-certified act of terrorism” means a violent act or an act that:

- (1) is dangerous to human life, property, or infrastructure that is committed by an individual or individuals, and
- (2) appears to be part of an effort to coerce a civilian population or to influence the policy or affect the conduct of any government by coercion, and
- (3) is not certified as a terrorist act pursuant to the Federal Terrorism Risk Insurance Act of 2002.

Generally, with exceptions, the limitations in the preceding section confine the application of this definition to incidents with at least \$25 million insured damage in the aggregate or 50 or more deaths or serious injuries.

Submission of Rates, Rules and Policy Form Language

Rate, rule and form filings will need to be submitted for commercial lines products (unless excepted from the Act, e.g. crop, livestock, medical malpractice) by all admitted carriers to comply with the Act. Surplus lines are not subject to rate, rule and form filing requirements. Personal lines products are not subject to the Act, and terrorism exclusions for personal lines products continue not to be permitted.

Washington is a “use and file” state for commercial lines rates, rules and forms with the exception of surety¹. Surety rates and rules are prior approval, but surety forms are not subject to filing requirements. The Act preempts state laws for prior approval for rates for terrorism risk insurance covered by the Act until December 31, 2003. For this reason Washington will consider surety rates and rules for terrorism coverage as eligible under use and file until December 31, 2003. This means that new rates, rules and forms subject to the Act can be issued before they are submitted as a filing. Filings must be received at the Office of the Insurance Commissioner (OIC) within 30 days of the effective date of the first policy that includes such

rate, rule or form. The filings remain subject to review under current applicable state law and must be corrected if disapproved. Where rates, rules, or forms are filed on behalf of an insurer by a rating organization or advisory organization, the insurer may need to file only for deviations or if not adopting the filing. Independent programs will require specific filings by each insurer.

If an insurer relies on an advisory organization to file loss costs and related rating systems on its behalf, no rate filing is required unless an insurer plans to use a different loss cost multiplier than is currently on file for coverage for *certified losses*. The rate filing should provide sufficient information for the reviewer to determine what price would be charged to a business seeking to cover *certified losses*, whether using rates, percentage multipliers, or other premium calculation methods. Insurers may choose to use rating plans that take into account other factors such as geography, building profile, proximity to target risks and other reasonable rating factors. The insurer should state in the filing the basis that it has for selection of the rates and rating systems that it chooses to apply. The supporting documentation should be sufficient for the reviewer to determine that the proposed rates are not excessive, inadequate, or unfairly discriminatory.

Insurers subject to policy form regulation must submit the policy language that they intend to use. The policy should define *acts of terrorism* and both *certified losses* and *non-certified losses* in ways that are consistent with the Act, state law and the guidance provided in this notice. The definitions, terms and conditions should be complete and accurately describe the coverage that will be provided in the policy. In Washington, the requirements for fire coverage are established by law and where applicable, must meet or exceed the provisions of the Standard Fire Policy. These legal requirements cannot be waived, and are not preempted by the Act. Thus, a business cannot voluntarily waive this statutorily mandated coverage.

The NAIC has provided to the States optional expedited filing and certification processes. Due to the existence of “use and file” filing laws, these processes and the EXPEDITED TRANSMITTAL DOCUMENT are not applicable in the State of Washington. Filings should be submitted in the normal way with the exception of inserting the key word “TERRORISM” in the filing description area of the transmittal form. This word will help identify filings for OIC internal priority procedures. See the OIC webpage for filing procedures and forms at: <http://www.insurance.wa.gov/p&c/guidelines.htm>.

Disclosure Notices

Disclosure notices are not required to be filed in Washington, but they are an integral part of the process for notification of policyholders and should be clear and not misleading. The disclosures should comply with the requirements of the Act and should be consistent with the policy language and rates filed by the insurer. Details about the applicable requirements are contained in the following two paragraphs.

In-force business receives special consideration under the Act. Section 105 (a) voids any terrorism exclusion on existing policies to the extent that it excludes losses that would otherwise be *insured losses* as defined in the Act. It details a process for insurers and policyholders to reinstate the voided exclusions. Under that process, an insurer may reinstate a preexisting provision in a contract that is in force on November 26, 2002, and that excludes coverage for an act of terrorism. However, the reinstatement is effective only if the insurer has either (1) received a written statement from the insured that affirmatively authorizes such reinstatement, or (2) if the insured fails to pay any increased premium charged by the insurer for providing such coverage and the insurer provided notice, at least 30 days before any such reinstatement as

provided in Section 105 of the Act. Copies of the NAIC model disclosure notices² are available on the OIC webpage at: <http://www.insurance.wa.gov/>.

There are also disclosures required for new business and renewal business. Although avoidance of contract language is not an issue, insurers must make certain disclosures to policyholders to remain in compliance with the Act and become eligible to receive compensation for its *insured losses*. Section 103(b)(2) requires insurers to provide clear and conspicuous disclosures to the policyholder of the premium charged for covered *insured losses* and advise that a federal program exists where the federal government will share significant portions of major *insured losses* with insurers. The required format of the disclosures depends on the relationship of the policy issue date to November 26, 2002. Section 103(c) requires the insurers to make coverage “available” for “acts of terrorism” as defined by the Act. An insured can choose not to buy the coverage (except for fire coverage), since the Act only requires coverage to be “available.” However, if the insured does buy coverage then the insurer needs to be very careful to provide the disclosures required, in addition to other prescribed procedures, in order to qualify for federal compensation if *insured losses* occur. If insurers do not comply with the Act, it is possible they could be obligated to pay *insured losses*, but not be eligible for federal compensation.

¹ 12-05-2002 Surety rates and rules for terrorism accepted on a “use and file” basis until 12-31-2003.

² 12-23-2002 Two NAIC model disclosure notices available on the OIC webpage.